IN THE

Supreme Court of the United States

OCTOBER TERM 1976

NO. 76-1645

GENERAL DYNAMICS CORPORATION,
Petitioner

v.

BOB BULLOCK, COMPTROLLER OF PUBLIC ACCOUNTS, ET AL.,
Respondents

PETITIONER'S REPLY TO RESPONDENT'S BRIEF IN OPPOSITION

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Rule 24, Paragraph 4	1

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The following reply is respectfully presented in accordance with the authority granted petitioner by Paragraph 4 of Rule 24 of this Honorable Court.

(1) Petitioner made no attempt to introduce new evidence.

In their first footnote respondents "take strong exception" to what they assert to be petitioner's effort to in-

troduce new evidence through footnotes 2 and 3 in the petition for certiorari. The only reasonable explanation for such a charge is the "recent change in assignments of attorneys" which prompted respondents to request and this Court to grant an extension of time for the filing of the reply brief. The information in the two footnotes comes from the stipulations upon the basis of which the case was initially tried. The figures shown in footnote 2 are set out in stipulation 8. The columns at the beginning of footnote 3 are taken from stipulation 9. The concluding paragraph of footnote 3 contains only mathematical computations based upon the previously listed stipulated amounts. The utilization of figures stipulated into evidence to derive percentages is not the introduction of new evidence.

(2) Petitioner did not attack the constitutionality of the Texas franchise tax statutes.

The first three cases cited by respondents, *Werner Machine Co. v. Director of Division of Taxation, Department of Treasury, New Jersey*, 350 U.S. 492 (1956); *Educational Films Corp. v. Ward*, 232 U.S. 373 (1931); and *Flint v. Stone Tracy Co.*, 220 U.S. 107 (1910), do no more than uphold the validity of various franchise tax provisions. The constitutionality of the Texas statutes has never been in issue here. That question was conclusively settled by this Court's decision in *Ford Motor Company v. Beauchamp*, 308 U.S. 331 (1939). It is equally significant to note that none of respondents' cited cases involves the Buck Act which is central to both questions raised by the application for certiorari here pending.

(3) This Court's decision on the Texas franchise tax is not subject to construction of the tax as being one "measured by income."

In *Ford Motor Company v. Beauchamp*, 308 U.S. 331 (1939), this Court in upholding the Texas franchise tax wrote (308 U.S. 375):

> "When that charge [payment for the privilege of carrying on business], as here, is based upon the proportion of the capital employed in Texas, calculated by the percentage of sales which are within the state, no provision of the Federal Constitution is violated."

That holding clearly construes the taxing provisions (Exhibit G to Application) as meaning that income is utilized only as a means of deriving the fraction or proportion or allocation percentage of a corporation's entire capital which can lawfully be taxed by the State of Texas: Gross receipts from business done in Texas divided by total gross receipts produces the fraction or percentage by which is determined the portion of the corporation's entire taxable capital which is taxable by the State of Texas. This Court so explained the tax in more detail on the basis of the particular figures involved in the reported case (308 U.S. 333-335). The tax is levied on the corporation's capital, not on its income. That conclusion is further enforced by this Court's initial description of the franchise tax as being (308 U.S. 332):

> "Measured by a graduated charge upon such proportion of the outstanding capital stock, surplus and undivided profits of the corporation, plus its long term obligation, as the gross receipts of its

> Texas business bear to the total gross receipts from its entire business."

Contrary to respondents' assertion (Ftn. 2), the above quoted language is not susceptible to construction of the franchise tax as being "measured by gross receipts." Moreover, at a later point in the opinion it was specifically held that the tax is "measured by capital whereever located" (308 U.S. 336). The basic provisions of the tax remain the same. The change is in the position of the respondents. In their defense of the franchise tax, the state officials at the time of the reported case conceded that they had no right to tax receipts from other states. This Court so noted (308 U.S. 337):

> "In so far as it was upon receipts in other states for work done in other states, it was conceded to be outside of the taxing power of the statute."

In the case at bar, however, respondents have added income from business done outside the State—on a Federal enclave—to income from business done within Texas in order to increase the fraction or percentage of petitioner's taxable capital which they assert is taxable by the State of Texas. It is at that point that the question of constitutionality arises.

(4) The Buck Act does not authorize the State to collect all types of franchise taxes on Federal enclaves.

Neither the Report of the Senate Committee on Finance (S. Rep. No. 1625, 76th Cong., 3rd Sess. 1940) nor *Howard v. Sinking Fund of the City of Louisville*, 344 U.S. 624 (1953), can properly be construed as interpreting the Buck Act to permit the collection of any and all categories of franchise taxes. Both the report and the opinion in their discussions of the Buck Act authorization of "income tax" emphasize that to qualify as an income tax the tax must be "levied on, with respect to, or measured by net income, gross income, or gross receipts."

As has been shown above, this Court has held that the Texas franchise tax is "measured by capital." Respondents, therefore, have been forced to rely almost entirely upon a single excerpt from *Southern Realty Corporation v. McCallum*, 65 F.2d 934, 935-936 (5th Cir. 1933), cert. den. 290 U.S. 692, where the Court stated that the "tax is not laid on property or on income, though both are regarded in measuring it." The apparent support of respondents' contention is semantic rather than legal. That the word "measuring," as applied to income, was used in that sentence solely with reference to the computation of the fraction or percentage of taxable capital to be taxed by the State is made abundantly clear by reading the sentence in context with the Court's immediately following explanation (65 F.2d 935-936):

> "The tax is not laid on property or on income, though both are regarded in measuring it. It is laid on the privilege granted to the corporation, whether domestic or foreign, to do business for one year in Texas with the capital set-up which it has chosen to use. The tax for this opportunity to do the year's business *is directly measured by the business capital about to be used, rather than by the income which it may afterwards appear was realized.*" (Emphasis added.)

Prior to the case at bar no Court, State or Federal, ever construed the Texas franchise tax as being levied on, with respect to, or measured by net income, gross income, or gross receipts.

(5) What is an "income tax" within the meaning of the Buck Act is a question of Federal—not State—law.

Respondents seek to prevent granting of the writ by taking the position that the correctness of the Texas Supreme Court's chacterization of the State franchise tax does not merit review by this Court. The cited cases, *Gurley v. Rhoden,* 421 U.S. 200 (1975), and *McLeod v. Delworth,* 322 U.S. 327 (1944), are not in point here except to the extent that they hold that this Court is the "final arbitor" when the meaning or the application of a State statute affects a subject of Federal jurisdiction. That clearly is the situation here. The Texas Supreme Court has made a distorted and strained interpretation of the franchise tax for the sole purpose of characterizing it as an "income tax" within the meaning of the Buck Act. That circumstances makes directly applicable the following holding from *Carpenter v. Shaw,* 280 U.S. 363, 367-368 (1930):

> "Where a federal right is concerned we are not bound by the characterization given to a state tax by state courts or Legislatures, or relieved by it from the duty of considering the real nature of the tax and its effect upon the federal right asserted."

Later decisions to the same effect include *Storaasli v. Minnesota,* 283 U.S. 57 (1931); *Society for Savings v. Bowers,* 349 U.S. 143 (1955); *California v. Buzard,* 382 U.S. 386 (1966); and *Cox Broadcasting Corp. v. Cohn,* 420 U.S. 469 (1975).

(6) The income tax cases cited by respondents more nearly refute than support the contention made.

The four lesser Federal Court decisions attributed by respondents to "this Court" do not equate a franchise within income. To the contrary in each instance the franchise or license was treated as a purchased asset. In *Elston Co. v. United States,* 21 F.Supp. 267 (Ct. Cl. 1937), and *United States v. Hardy,* (4th Cir. 1935), the Courts held that purchased liquor authorities terminated by national prohibition should be treated as any other lost properties in computing Federal income taxes. Those holdings were applied to an amusement park franchise in *Philadelphia Park Amusement Co. v. United States,* 126 F.Supp. 184 (Ct. Cl. 1954). In *Baxter v. C.I.R.,* 433 F.2d 757 (9th Cir. 1970)—erroneously cited as 443 F.2d 757—franchises were treated as business assets and salable properties. Those holdings are all in accord with this Court's statement in the *Ford Motor Company* case that the Texas franchise tax is "payment for the privilege of carrying on business" (308 U.S. 334). Since the taxpayer is making "payment" for a business asset, it cannot logically be held that it is at the same time being taxed on its "income." The concept that anything acquired by "payment" can concurrently be "income" and be taxed as such is beyond the normal understanding of reasonable men. Unquestionably the Buck Act definition of "income tax" is in broad language, but despite

its breadth, it never has been and logically cannot be interpreted so broadly as to include a tax imposed for a "privilege" acquired by "payment." If Congress had intended to permit the States to levy taxes on franchises utilized on Federal enclaves, it could and would have plainly so stated in the Buck Act.

(7) Respondents disregard the "exclusive jurisdiction" of Congress.

The only Buck Act cases even mentioned in respondents' brief are those cited by petitioner in its application as either directly or indirectly—because of the difference in the taxes involved—supporting its contention here. Respondents' attempted distinctions are meritless. The nature of a Federal enclave and the tests of the State's taxing power are the same or substantially the same regardless of the subdivision of the Buck Act upon which the taxing authority seeks to rely.

CONCLUSION

The decision of the Court below has not been and cannot be supported by any illegal authority. That Court has, nevertheless, assumed to decide a significant, substantial Federal question in a manner which is totally inconsistent with this Court's most applicable decisions. The Congress rather than the Texas Supreme Court has the right, power and authority to relinquish exclusive jurisdiction over Federal enclaves. Petitioner, therefore,

prays as before that this petition for writ of certiorari be granted.

Respectfully submitted

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CERTIFICATE OF SERVICE

I, Mary Joe Carroll, a member of the Bar of the Supreme Court of the United States, hereby certify that I have served the foregoing Petitioner's Reply to Respondents' Brief in Opposition on counsel for respondents by depositing same in the United States mail, postage prepaid, on July _____, 1977, addressed to The Honorable John L. Hill, Attorney General of Texas, and to Messrs. David M. Kendall, Steve Bickerstaff, and Lonnie F. Zwiener, Assistant Attorneys General, P. O. Box 12548, Capitol Station, Austin, Texas 78711.

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